

May 22, 2002

D.T.E. 00-99

Investigation by the Department of Telecommunications and Energy on its own motion into whether Bay State Gas Company's decision to enter into transportation agreements with Portland Natural Gas Transmission System was prudent and in the public interest.

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## I. INTRODUCTION AND PROCEDURAL HISTORY

On December 21, 1995, Bay State Gas Company (“Bay State” or “Company”) filed with the Department of Telecommunications and Energy (“Department”) a Precedent Agreement between Bay State and Portland Natural Gas Transmission System (“PNGTS”) for purchase of capacity.<sup>1</sup> On January 12, 1998, Bay State filed with the Department two firm transportation contracts entered into by Bay State and PNGTS and executed as successors to the previously filed Precedent Agreement.

On March 30, 1998, the Department approved the firm transportation contracts, Bay State Gas Company, D.T.E. 95-128 (Letter Order, March 30, 1998). In its Letter Order, the Department stated that the approval of the agreements did not represent a finding that the contracts were prudent or in the public interest. Id.

Shortly after the issuance of the Department’s Letter Order, Bay State submitted its forecast and supply plan for our consideration. In its approval of Bay State’s forecast and supply plan, the Department indicated that we would consider two issues associated with the PNGTS agreements: (1) the appropriateness of Bay State’s decision to increase its capacity commitments with the PNGTS agreement at a time when the Massachusetts natural gas market was opening to competitive markets; and (2) the appropriateness of Bay State’s decision to enter into a 20-year agreement with PNGTS. Bay State Gas Company, D.T.E. 98-86, at 27 (2000). To investigate these issues, the Department directed Bay State to submit

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<sup>1</sup> At the time of the execution of the Precedent Agreement, Natural Gas Development Corporation held a minority interest in PNGTS (Exh. RR-AG-1). Bay State was an affiliate of Natural Gas Development Corporation (Exh. DTE 2-9).

documentation to establish that Bay State's execution of the contracts was prudent and in the public interest. Id.

In compliance with the Department's directives, on November 3, 2000, Bay State submitted to the Department a report identifying the Company's reasons for executing the transportation agreements with PNGTS. The Department docketed the Company's filing as D.T.E. 00-99.

Pursuant to notice duly issued, on January 8, 2001, the Department conducted a public hearing to afford interested persons the opportunity to comment on the Company's filing. Evidentiary hearings were held on April 11, 2001, and April 27, 2001. The Attorney General of the Commonwealth of Massachusetts ("Attorney General") intervened as of right pursuant to G.L. c 12, §11E. Boston Gas Company d/b/a KeySpan Energy Delivery was granted limited participant status.

In support of its petition, the Company offered the testimony of three witnesses: Joseph A. Ferro, manager of regulatory policy; Francisco DaFonte, director of gas control; and Daniel P. Yardley, principal, Yardley and Associates. Briefs were submitted by the Attorney General and Bay State on May 22, 2001 and June 8, 2001, respectively.

## II. POSITIONS OF THE PARTIES

### A. The Company

Bay State argues that its decision to increase capacity commitments by executing the agreements with PNGTS at a time when the Massachusetts natural gas market was becoming competitive, was appropriate (Bay State Brief at 18). Bay State indicated that the need to

explore options for additional resource capacity began in October 1993, when the Portland Pipeline (“PPL”) notified Granite State Transmission Company (“Granite”) of the termination of Granite’s lease effective March 31, 1996 (id. at 9).<sup>2</sup> The lease termination would have resulted in a loss of 25,279 Dekatherms (“Dth”) per day of base load transportation capacity to deliver Canadian supplies (id.). Bay State claimed that the reduction of the base load transportation capacity would effectively prevent it from providing reliable service to its existing customer base (id. at 9-10).

To ensure that the portfolio objectives were met, Bay State notes that it evaluated resource options in accordance with a Department-approved supply planning process and selected PNGTS to procure capacity pursuant to an evaluative process that was approved by the Department (id. at 11). Specifically, the Company states that PNGTS was selected in accordance with a Department-approved statistical model to determine the least-cost resource acquisitions (id.).

The Company notes that 1995 marked a time of uncertainty in the retail gas industry (id. at 19). The Company acknowledged that it was likely that markets would transform to some degree between 1995 and 2015 (i.e., the term of the agreements with PNGTS), but that it was difficult to predict the precise manner of the change in retail markets (id. at 20). Bay State contends that based on the circumstances that existed in 1995, the Company expected that it would be required to continue to procure resources for its customers and maintain its

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<sup>2</sup> The Company indicated that much of Bay State’s interstate capacity was held by Granite on Bay State’s behalf. Granite is an affiliate of Bay State and leased capacity on the Portland pipeline (Exh. BSG-1 at 3).

obligation to serve regardless of potential future migration (id. at 21). Thus, the Company entered into the agreement with PNGTS to ensure that primary delivery point capacity was available to serve total demand in its service territory including that of potential transportation customers (id.). Moreover, Bay State contends that it reasonably believed that even if significant migration of customers occurred, given the constrained New England marketplace, gas marketers would likely purchase Bay State's capacity (id.).

In addition to arguing that it was reasonable for Bay State to enter into the PNGTS agreements even though Massachusetts natural gas markets were becoming competitive, the Company contends that the 20-year term of the PNGTS agreement was appropriate (id.). Bay State maintains that in 1995, market conditions in the northeast dictated that incremental capacity contracts required 20-year terms (id. at 22). In fact, Bay State notes that all contracts entered into by other shippers for PNGTS capacity at the time of Bay State's contract were for 20 years – which was the industry standard in 1995 (id.).

In response to the Attorney General's criticism that the agreements have "open-ended pricing terms", Bay State argues that any cost increases implemented by PNGTS under the agreements are subject to the review and approval of FERC and that Bay State has the right to oppose any such requests before that agency (id. at 28). The Company claims that all capacity contracts available to them in 1995 had cost provisions similar to those in the PNGTS contracts (id.).

B. The Attorney General

The Attorney General requests the Department to find that recovery of the PNGTS costs would be on a different footing than that of other previously-approved long term transportation agreements (Attorney General Letter Brief at 2-3). The Attorney General submits that potential “stranded” costs could result from a change in current requirements that migrating customers take a pro-rata share of existing capacity (id. at 2). The Attorney General argues that any of those stranded costs should be non-recoverable since Bay State was on notice and aware of the pending changes in the structure of the gas market in 1995 (id.). The Attorney General argues that even if there are merits from a business or regional development perspective that caused Bay State to execute a 20-year agreement with PNGTS, the decision was neither prudent nor in the public interest if based upon an expectation that its customers would bear the risk of the market value of that capacity (id.).

III. ANALYSIS AND FINDINGS

The Department notes that Bay State’s supply planning process was approved previously by the Department. Bay State Gas Company, D.T.E. 98-86 (2000); Bay State Gas Company, D.P.U. 93-129 (1996). Moreover, the evidence indicates that PNGTS was selected to provide capacity based on the previously-approved planning process. Hence, the Department has limited the focus of this investigation to (1) whether Bay State appropriately entered into capacity commitments by executing the PNGTS agreements at a time when the Massachusetts natural gas market was becoming competitive; and (2) whether Bay State

appropriately executed a 20-year agreement with PNGTS. Bay State Gas Company, D.T.E. 98-86, at 27 (2000).

At the time that Bay State executed its agreements with PNGTS, the competitive gas market in Massachusetts was in an embryonic stage. Although the Department and industry participants expected that the competitive gas market would develop, there was uncertainty about when the competitive marketplace would emerge, and, once it did, what role the LDCs would play within that market.<sup>3</sup> Mere awareness that a competitive gas market may, or even is likely to, develop is no guarantee that the marketplace will develop in fact. In the meantime, the Company had to operate in the market as it then stood and deal with the conditions that obtained. Despite the changing gas marketplace, the Department approved Bay State's forecast and supply plan wherein the Company indicated the need to purchase capacity as a result of the termination of the Portland Pipeline ("Portland") lease. Under the Portland lease, Bay State had access to firm, annual capacity which allowed Bay State to receive baseload transportation for Canadian commodity ( Exh. BSG-1 at 3, 15). When Portland notified Bay State that it intended to terminate the lease effective March 1996 and reconvert the line to deliver crude oil, Bay State had to search for an alternate source (Exhs. BSG-1 at 3, 15; DTE-1-1; DTE-1-2; Tr. at 188). Consequently, after appropriate review of various resource alternatives,<sup>4</sup> Bay

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<sup>3</sup> In Gas Unbundling, D.T.E. 98-32-B, at 41 (1999), the Department found that the interstate capacity market was not fully competitive and that the Massachusetts LDCs were still responsible for planning and procuring gas supplies.

<sup>4</sup> In. D.T.E.98-86 at 27 (2000), the Department approved the statistical model that Bay State used to select PNGTS for the capacity.

State committed to PNGTS to replace the expiring Portland lease and to meet the projected average annual growth rate of 3.9 percent (Exh. BSG-1 at 15, 16). Accordingly, the Department finds that Bay State appropriately entered into its capacity commitments with PNGTS even though emergent competitive market developments were in process, albeit still inchoate.

Similarly, the record indicates that given the market conditions in 1995, a 20-year term for capacity contracts was the industry practice (Exhs. BSG-1 at 36-37; DTE 1-13; DTE 2-27; Tr. at 22-23, 64-65, 115, 119, 226-227). Moreover, the record shows that regardless of which capacity resource Bay State selected (using the Department-approved supply planning process), a 20-year contract term would have been required (Bay State Brief at 23). Based on this evidence, the Department finds that Bay State appropriately executed agreements with PNGTS for a 20-year term.

#### IV. ORDER

Accordingly, after due notice and consideration, it is

ORDERED: That Bay State Gas Company's firm transportation contracts as executed



with Portland Natural Gas Transmission System in 1998, in accordance with the terms of a precedent agreement executed in 1995, were prudent.

By Order of the Department,

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Paul B. Vasington, Chairman

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James Connelly, Commissioner

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W. Robert Keating, Commissioner

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Eugene J. Sullivan, Jr., Commissioner

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Deirdre K. Manning, Commissioner

Appeal as to matters of law from any final decision, order or ruling of the Commission may be taken to the Supreme Judicial Court by an aggrieved party in interest by the filing of a written petition praying that the Order of the Commission be modified or set aside in whole or in part.

Such petition for appeal shall be filed with the Secretary of the Commission within twenty days after the date of service of the decision, order or ruling of the Commission, or within such further time as the Commission may allow upon request filed prior to the expiration of twenty days after the date of service of said decision, order or ruling. Within ten days after such petition has been filed, the appealing party shall enter the appeal in the Supreme Judicial Court sitting in Suffolk County by filing a copy thereof with the Clerk of said Court. (Sec. 5, Chapter 25, G.L. Ter. Ed., as most recently amended by Chapter 485 of the Acts of 1971).